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THE REFORM OF TRADE REMEDY RULES: PROPOSALS FOR DISCUSSION

MINISTRY OF INTERNATIONAL AND
INTERGOVERNMENTAL RELATIONS

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Introduction

Over the past several years, Canadian and Albertan producers have had to cope with countervailing duty and anti-dumping actions directed against their products. The issue of trade rules reform is now being considered in current round of trade negotiations in the World Trade Organization (WTO).

In these negotiations, the Government of Alberta has urged the Government of Canada to adopt a broad perspective that considers the relationship of trade remedies to international competitiveness and the economic changes brought about by globalization. Such an approach would be in the best long-term interests of producers, exporters, importers, and consumers. Alberta believes that current trade remedy systems are deeply flawed, and that our long-term objective should be to work toward the fundamental reform of anti-dumping and countervail in the context of continued market liberalization. Canada's trade policies must be focused on the future, and must give producers and consumers the tools necessary to adapt and prosper in a rapidly-changing world. This will not happen if trade rules interfere with the efforts of producers and consumers to respond to market signals and interfere with normal competitive activity.

In the Uruguay Round of multilateral trade negotiations, the Alberta government encouraged the Government of Canada to promote the "net-subsidy" approach. Under this approach, countervailing duties could only be imposed on imported products to the extent that they received subsidies greater than the subsidies received by the industry that started the trade case. The Government of Canada accepted this approach and included it in its negotiating position in the Uruguay Round. While this proposal did not receive sufficient support at that time, Alberta believes the proposal still has merit, and urges that it be considered again in the current WTO negotiations. At the same time, every effort must be made to curtail the abuses of current systems as quickly as possible, and thus Alberta has provided suggestions to this end:

- In 2000, based on Alberta's experiences in agricultural trade cases, the province considered what changes could be made to make the operation of antidumping rules fairer in the agricultural sector, particularly for cyclical industries. The Alberta discussion paper, developed in consultation with the Washington, D.C. firm of Arnold & Porter of, counsel for the Government of Alberta, can be found at: http://www.iir.gov.ab.ca/trade_policy/pdfs/2.4f.12b-AgProducts_Antidumping_Sept00.pdf.

- In 2002, working again with Arnold & Porter, Alberta developed additional proposals covering both the WTO Subsidies and Antidumping Agreements. These proposals cover a range of options from policy changes to specific changes in the application of countervailing and antidumping measures. That paper can be found at: http://www.iir.gov.ab.ca/trade_policy/pdfs/WTO_subsidies_antidumping_proposals_Oct02.pdf.

- In 2004, we returned to the theme of anti-dumping rules and agriculture, first raised in 2000. The 2000 paper noted the pernicious impact of the "below-cost" test for cyclical agricultural products caught up in anti-dumping investigations. In cooperation with Arnold & Porter, we explored this issue further and offered several suggestions for reform. While our ultimate objective is to see fundamental reforms to trade remedy regimes, making them consistent with the principle of "national treatment", the unique characteristics of agriculture present opportunities for more immediate changes. This discussion paper, posted in April 2005, is available at: http://www.iir.gov.ab.ca/trade_policy/documents/Below-Cost_Test_in_Agric_AD_Cases-Apr05.pdf.

I. GENERAL IMPROVEMENTS TO THE WTO SUBSIDIES AND ANTIDUMPING AGREEMENTS

The first set of proposed reforms is intended to mitigate the more egregiously unfair aspects of antidumping and countervailing duty proceedings. The highly technical nature of these investigations can prevent outsiders from perceiving the important inequities created by the methodologies being applied. Indeed, effective reforms to these agreements often will involve changing details of various methodologies currently in use that can not be described in simple terms. Nonetheless, the impact of making many of these technical changes would be significant.

A. Proposed Changes to the WTO *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement")

- The expiry of the "serious prejudice" deeming provision (SCM Article 6.1) makes it difficult to pursue remedies against trade distorting subsidies in foreign markets. Revitalizing this tool is critical, given the increasing importance of exports to the Canadian economy, and the desire of Canadian exporters to compete on a level playing field.

- The expiry of the "green-light" subsidy category (SCM Article 8.2) compromises the traffic light approach. However, if revived, these provisions need to be revised and clarified:

    - For example, it was unclear whether the regional development exemption in SCM Article 8.2(b) applied to actions taken by subnational governments, and, if it did, whether national income or employment figures had to be used.

    - In addition, the research and development support criteria to be met for "green-light" status appeared to be too rigid. This may have hindered many useful research and development activities.

    - More generally, it would have been difficult for existing programs to fit under SCM Articles 8.2(a), (b) or (c). While programs could have been designed, on a prospective basis, to fit the detailed criteria, existing programs that had a similar effect and were no more trade-distorting, would have been vulnerable to attack.

- The WTO has ruled that timber harvesting rights are a "financial contribution" under SCM Article 1.1(a)(1). It is very unlikely that other countries (i.e., the U.S.) would ever accept a proposal from Canada to exempt natural resource pricing decisions from trade rules.

    - However, these rules still ought to be negotiable. The application of a market pricing benchmark, for example, does not fully recognize the other values that governments might try to maximize as they manage their resources. Consideration should be given to the development of new rules that fairly address the trade distorting potential of resource management activity, while still respecting the importance of these other values.

- In the softwood lumber CVD case, the WTO ruled that a pass-through analysis is needed to determine the extent to which downstream purchasers of log inputs benefited from any stumpage subsidies. However, the SCM Agreement does not set out a methodology for doing this.

- The practical application of the specificity rules in SCM Article 2.1 is unclear:

  - It is unclear how Article 2.1(b) is qualified by Article 2.1(c), and no indication is given how the factors outlined in Article 2.1(c) are to be assessed and applied. For example, it is unclear how the "extent of diversification of economic activities" is to be taken into account.

  - Article 2.1(c) also might need to be clarified to avoid findings of specificity in cases involving the extraction or processing of government-owned natural resources, when any limited use of the resource is not due to government action or when different industries have needs for substantially different quantities of the resource.

  - The concepts of "predominant use" by certain enterprises and the granting of "disproportionately large" amounts of subsidy to certain enterprises also need to be clarified to ensure findings of specificity do not occur on these grounds when such enterprises receive less than 50% of the alleged subsidy being examined.

- Consideration should be given to having the same 2% de minimis rate for developed and developing countries.

B. Proposed Changes to the WTO *Antidumping Agreement* ("AD Agreement")

- The economic concept of "dumping" should be defined, to provide a guidepost for measuring it. Is it a price discrimination rule, a prohibition on below cost sales, or something else?

  - For example, if a company produces only for export, and all its exports go to one country, should there be a basis for finding dumping if its sales are above cost? Must every single sale be above cost? The use of constructed value comparisons in such cases, with its requirement of a profit component, inherently involves the imputation of arbitrary profit rates. Why should international trading rules require any particular profit level, much less one the exporter has no way of knowing at the time it makes its sales?

- Consideration should be given to limiting the application of dumping remedies to cases where the examined producers have pricing power. In highly fragmented industries, where all participants are price takers, does it make sense to penalize producers for prices over which they have no control? This issue could be addressed using a market concentration test of the sort used in the antitrust context.

- The concept of "sales in the ordinary course of trade" (AD Article 2.2.1) needs to be clarified. In particular, whether sales below cost are made within "an extended period of time" and whether prices do not provide for the recovery of all costs "within a reasonable period of time" needs to be assessed in light of the circumstances and

typical commercial practice of the relevant industry. We explore this more detail, below, with regard to agriculture.

- Consideration also should be given to eliminating, or at least modifying, the "below cost" test for certain industries or products. In particular, agricultural products (and not just highly perishable products) frequently must be sold below cost, due to their long production time frame and price cycles. They should be exempted from the below cost test, because frequent below cost sales are normal and necessary. We discuss this in more detail below.

    - Alternatively, raise the de minimis thresholds for agricultural products and other products where producers do not have market power, and where price cycles can result in extended periods of sales below full cost for all participants in the industry, whether foreign or domestic.

- The allocation of costs and profits to different products produced by the same company must be done fairly, and in a manner that considers the reasons that costs are incurred and the particular factual circumstances of each case.

    - For example, in constructed value calculations, high profits enjoyed by some product lines should not be attributed to less profitable product lines.

    - One way of addressing the profit problem is to require that countries apply commercially relevant, consistent definitions of the "like product" for both price comparison and for constructed value profit purposes. For example, if price comparisons are made treating each species, grade, and dimension of lumber as a distinct like product, then in computing constructed value profit, there should be a separate profit rate computed for each such product.

    - Alternatively, rules could require that prices and costs be matched at the same level of specificity. For most agricultural products, for example, different grades of a product will be produced (and will have different prices), but the producer will be able to compute only a single average cost. If this average cost then is compared for cost of production and constructed value purposes to the price of each individual grade, the dumping rules effectively will prohibit the exportation of lower grade products. The remedy is either to allocate costs to different products in relation to their value, or to average prices for comparison purposes at the same level of specificity that costs can be calculated. We discuss this in more detail below.

- Consideration should be given to providing more detailed rules governing the calculation of costs of production and to explicitly excluding certain types of costs from the calculation of cost of production and constructed value.

    - Financial expenses, for example, are difficult to allocate to individual products. Equity, moreover, is not treated as a cost. Why should a company's choice of capital structure affect the prices it must charge?

    - Another category of costs that should be examined is the cost for idling or shutting down plants. One of the objectives in an AD case is to reduce the flow

of imports. When duties are imposed, the foreign manufacturer may consider shutting down plants. If, however, idling and shutdown costs are counted as costs of production for the remaining merchandise produced, the unit costs are increased, thereby creating a vicious spiral that increases the dumping duties.

- Finally, thought needs to be given to certain intangible and contingent costs, like goodwill, stock options, etc. For example, Canadian GAAP now has changed to prohibit the amortization of goodwill. Instead goodwill is subject to an annual impairment test. Under current antidumping law, if a product or market deteriorates, and a company writes off some of its investment as goodwill impairment, that write-off can be treated as a current production cost. This could greatly increase a company's cost of production, and hence its dumping margin, at the very time the market has deteriorated. There needs to be some recognition that not every expense on a company's books can or should be recovered in the pricing of a product.

- The AD Agreement should be clarified to ensure that the only duties that can be imposed are those provided for, and the only adjustments that can be made are those provided for. Specifically, aim should be taken at the U.S. "anti-reimbursement regulation" under which the U.S. effectively doubles the AD or CVD duty rate unless the importer certifies that the producer or exporter did not either pay the AD or CVD duties, or reimburse the importer for such duties. This regulation has very pernicious effects, such as making it difficult to sell a product to an unaffiliated importer using consignment or commission arrangements.

- Given the arbitrary assumptions and high degree of variance and uncertainty in anti-dumping calculations, the de minimis level could be raised to reduce the impact of these problems.

- While recent decisions appear to prohibit "zeroing," it would be helpful to clarify AD Agreement Article 2.4.2 to rule out the use of this practice explicitly.

- Zero or de minimis rates calculated for individual company respondents should be included in the calculation of the "all-others" rate applicable to other exporters.

- Dumping calculations in reviews should use the same methodologies as those used in investigations (e.g., price averaging for dumping price comparisons).

- AD Agreement Article 17.6 provides for a special standard of review for the adjudication of disputes arising out of AD investigations. The standard used by panels in other cases under the *Dispute Settlement Understanding* should apply to AD cases. The predictability of WTO dispute resolution will be undermined if there are multiple, potentially inconsistent, "permissible" interpretations of Antidumping Agreement provisions

C. Proposed Changes to both the Subsidies and Antidumping Agreements

- The concept of "negligible" imports should be defined in the SCM Agreement, and possibly redefined in the AD Agreement. Even if the current 3% level in the AD Agreement remains intact, the 7% "total import" rule could be eliminated. The risk of

Canada being caught in a trade investigation should not be increased by the mere presence of other alleged dumping countries. Those who favour keeping the current rules might argue, for example, that commodity products are more price-sensitive, and are more likely to be harmed by so-called "negligible" levels of imports. However, when commodity products are sold into integrated markets, where all producers are responding to similar price signals, it is more likely that harm is being caused by other economic factors, not by dumped imports.

- Should countervail and anti-dumping duties only be imposed on imports to the extent that they exceed the de minimis level? This has been suggested in respect of imports from developing countries in countervail cases, but is there any reason why it should not apply to goods from all countries?

- The same de minimis rules should apply for both initial investigations and reviews.

- The "lesser duty rule" should be made mandatory when imposing countervailing and anti-dumping duties. Investigating authorities, while examining the causal link between subsidized/dumped imports and the state of the domestic industry, must not only distinguish the harm caused by the subsidies on, or dumped prices of, imports from the harm caused by other factors. They also must quantify the proportion of the harm caused by the subsidies or dumping, and require that duties be imposed only at the level necessary to offset the harm caused by these practices.

- A public interest inquiry should be mandatory in all CVD and AD investigations and all reviews to ensure that enforcement of trade rules does not penalize consumers and purchasers of inputs, while doing little to encourage the development of competitive markets. In the U.S., for example, there is no mechanism to reduce or eliminate duties even when the costs of trade action to consumers/input purchasers outweigh the benefits to petitioning producers (e.g., softwood lumber, steel).

    - This concept may be difficult to implement, and any decision to modify (or not, as the case may be) the relief available to petitioners will be controversial. It is also unclear whether stringent WTO review of this type of requirement is feasible (that is, aside from requiring domestic authorities to weigh the economic costs and benefits of imposing duties at a given level, how can the WTO evaluate the fairness of the domestic assessment, when it involves balancing quintessentially domestic political issues?) However, expanding the power of multiple stakeholders to affect the outcome of trade proceedings may exert some discipline over the development and application of domestic trade laws.

- Product under investigation/"like product": Rules should be clarified so that specific products are not lumped together and treated as the same like product if they, in fact, compete in different market segments. These distinctions would be respected consistently when determining standing and injury, as well as when evaluating subsidies or dumping.

- Standing/definition of "domestic industry": While a petition requires the support of producers representing over 50% of total domestic production that expresses a view, a case can go ahead when only 25% of the domestic industry is in favour. Perhaps this two-part test should be turned into a simple requirement that at least 50% of the

domestic industry needs to support the petition. This would lessen the risk of trade cases being launched at the behest of small, but well-organized lobbies that do not represent the interests of the majority of the industry.

- There also needs to be clarification of how the views of employees are supposed to be taken into account when the level of industry support is being considered, particularly when the views of management might differ. Similarly, it will be important to clarify who qualifies as a worker in the industry. The status of unemployed workers, ancillary unions, and wholesalers in determining industry support for a petition remains unclear.

- More specialized rules may be needed to determine standing when firms are represented by industry associations or workers are represented by unions. For example, is it appropriate for all the members of an industry association to be considered to support a petition when only a bare majority of members is in favour of initiating a case? Perhaps industry support information from associations should be accepted only if there is verifiable data regarding the members of the association (identity, volume of production, whether they voted, and how they voted, etc.). Further, the votes would be counted individually and only once for each producer. This would solve the problem of overlapping association membership leading to double-counting of supposed support. While this might disadvantage less-organized associations, it would help prevent the initiation of cases where support cannot be shown to exist.

    - Alternatively, a provision could be added requiring that industry support be demonstrated by actual producers only, not by surrogates like trade associations.

- It also needs to be considered what impact these potential new rules for determining standing might have on determining the levels of exporting industry "support" for anti-dumping undertakings.

- Given the length, complexity, and cost of trade investigations, consideration should be given to an expedited dispute resolution process to ensure that there has been compliance with rules dealing with the initiation of trade cases (e.g., standing, product definition, evidence of subsidy/dumping, injury, causation, etc.)

- A requirement should be added that injury be assessed within the context of the business cycle of the industry examined. Certain industries are highly cyclical; the downturn in the cycle should not be regarded as injury warranting trade relief.

II. AGRICULTURE AND ANTI-DUMPING RULES

Introduction

Under WTO agreements, countries are permitted to impose antidumping duties as a remedy for injurious international price discrimination. Under the WTO AD Agreement, a product is considered dumped if the price of the product, when exported from one country to another, is less than its "normal value." The "normal value" generally is the comparable price, in the ordinary course of trade, for the like product when destined for domestic consumption in the exporting country, or, if such sales are insufficient, in an appropriate third country[1].

- Many of our suggestions for reform are shaped by our experience with U.S. trade laws. Under U.S. antidumping law, the U.S. may impose duties to offset the difference between the higher price at which merchandise is sold in the producing country (or a third-country, if not sold in the producing country in sufficient volumes) and the lower price at which the goods are sold in the U.S.

    - In an initial antidumping investigation, the U.S. Commerce Department ("Commerce") generally compares, on a product-specific basis, the weighted average U.S. price, net of all movement and selling expenses, during the period of investigation ("POI"), to the weighted average home-market/third-country price, net of all movement and selling expenses, during the same period. Generally, the period of investigation used is a one-year period ending in the calendar quarter preceding the month in which the petition is filed. (In an administrative review, Commerce compares monthly average home-market or third-country prices with each individual U.S. sale made in that month.)

    - The calculation of the margin of dumping also can involve use of a below-cost test. Below-cost home market/third-country sales can be excluded in calculating the home market/third-country price[2]. This means that anti-dumping margins

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[1] AD Agreement, Articles 2.1 and 2.2.

[2] The exclusion of below-cost sales is provided for in Article 2.2.1 of the *AD Agreement*, which states as follows:

> "Sales of the like product in the domestic market of the exporting country or sales to a third country at prices below per unit (fixed and variable) costs of production plus administrative, selling and general costs may be treated as not being in the ordinary course of trade by reason of price and may be disregarded in determining normal value only if the authorities determine that such sales are made within an extended period of time in substantial quantities and are at prices which do not provide for the recovery of all costs within a reasonable period of time. If prices which are below per unit costs at the time of sale are above weighted average per unit costs for the period of investigation, such prices shall be considered to provide for recovery of costs within a reasonable period of time." Art. 2.2.1.

The paragraph further provides that the "extended period of time" "should normally be one year but shall in no case be less than six months." Art. 2.2.1, note 4. Sales below cost are made in "substantial quantities" "... when the authorities establish the weighted average selling price of the transactions under consideration for the determination of normal value is below the weighted average per unit costs, or that

generally increase as more below-cost sales are found, since exclusion of the low price sales pushes up the average price of the remaining sales in the sample period. We discuss below-cost sales in much greater detail below.

- In the last decade, there have been a number of U.S. antidumping investigations involving agricultural products that have served to highlight unique problems in analyzing agricultural industries and products under traditional antidumping analysis. These investigations have included not only cattle, swine and wheat from Canada, but also fresh Atlantic salmon from Chile, fresh Atlantic Salmon from Norway, roses from Colombia, roses from Ecuador, and fresh cut flowers from Colombia, among others.

- The traditional U.S. dumping investigation involves a manufactured product in an industry where there are relatively small numbers of foreign producers and competing U.S. producers. Each producer sells a branded or otherwise differentiated product, and often has some ability to set prices. Costs of production can be calculated easily, since the manufacturer usually uses product-specific cost accounting. Different product models can be assigned different costs because different component materials are used. Prices tend to be relatively stable, since there is little seasonality or cyclicality, and producers can react to short-term changes in demand by varying production and/or inventory. The highest dumping margins tend to be found when the home market is to some degree protected, allowing the foreign producer to charge higher prices at home, due to the absence of any ability for a third-party to engage in arbitrage.

- Agricultural industries differ from manufacturing industries in important respects. This is particularly true with regard to the production of unprocessed, direct farm or fishery products. The number of producers in the industry can be very large, and the industry can be highly fragmented, in both the producing and importing country. Also, the production cycle can be lengthy. For example, crops will take months to grow and harvest, cattle and swine will take years to grow from birth to market weight, and farmed salmon will take about three years for the fertilized egg to mature into a marketable product.

    - As a result of these two factors alone, individual producers are more likely not to have control over prices, but rather are classic price takers in economic terms. Indeed, they may sell through auctions or may respond to bids by major purchasers. Even in agricultural industries where the number of producers is relatively small, an individual producer may, in practical terms, have little control over prices due the high perishability of its product, and/or the inability to increase or decrease product in the short-term due to the lengthy production cycle.

    - Whereas a manufacturer can simply purchase fewer inputs or idle capacity in the face of short-term declines in demand, an agricultural producer may have no such flexibility. The flower must be cut or it will perish. The wheat and corn must

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the volume of sales below per unit cost represents not less than 20% of the volume sold in transactions under consideration for the determination of the normal value." Art. 2.2.1, note 5.

be cut before they spoil. Livestock continue to grow, regardless of short-term demand fluctuations. As a result, the supply of agricultural products on the market during a given, often multi-year period, cannot change significantly, whether the prices are high or low. This, in turn, means that agricultural producers do not pose the threat of deliberate price cutting behavior which seems to be the justification for the below-cost sale exclusion rate.

- The calculation of an accurate cost of production for individual "models" of an agricultural product also may be impossible. "Model" differences in agricultural products tend to revolve around size or quality/grade differences, which generally are not reflected in computable differences in the particular "models'" costs of production. For example, a salmon farmer will obtain different prices in the market per kilogram for salmon of different quality and size, yet will not be able to point to different costs incurred to produce its different grade and size salmon. A mushroom grower will obtain different prices in the market for different size mushrooms, but all are jointly produced in the same production processing using the same materials and processing.

- The joint production of high and low value products can cause the low value products to be charged with one average cost that will be higher than warranted, given the product's market value. This in turn can result in lower value products being eliminated from normal value calculations, as below cost, which will result in an antidumping analysis for those products that is not based on real market prices for that kind of goods. Inevitably, this analysis raises the dumping margin.

- In addition, prices for agricultural products may be cyclical, seasonal, or otherwise fluctuate greatly. For example, certain agricultural products may have historical boom and bust pricing cycles, such as the well-recognized multi-year hog and cattle cycles in North America, where producers expand herds as prices increase. Then, the resulting production increases cause prices to fall, which results in herd contraction and then increasing prices. Likewise, prices may be subject to regular seasonal fluctuation, due to recurring supply or demand variations. Overall, when the pricing is reviewed over the industry's cycle, it generates profits. However, at certain points, it may be well known that all producers are losing money.

- Agricultural products also tend to be commodities, with little or no branding or other differentiation among the products produced and sold in different countries. Barriers to entry also tend to be low. These factors tend to increase price volatility as demand, and to a lesser extent, supply, can fluctuate greatly.

- These attributes of agricultural products and industries can distort the antidumping analysis, if traditional methodologies are applied without modification. For example:

  - The existence of large numbers of producers creates problems for the importing country in determining whether a petition has the requisite level of industry support. Where there are hundreds or even thousands of individual producers in the exporting country, it is difficult to ensure the selection of representative respondents and the calculation of representative dumping margins.

- The high perishability of certain agricultural products, and/or the inability to control production in the short-term, may mean that producers have no choice but to continue producing and selling their products, even under poor market conditions and declining prices, because they cannot decrease production in response to short-term price declines.

- The existence of boom and bust or seasonal pricing cycles can make it necessary for producers to sell at below-cost prices for extended periods of time during the down phase of the cycle, whereas average prices may be above cost over the entire cycle.

- Similarly, dumping margins can be exacerbated by the existence of non-cost-based value and price differences tied to grade, size or other quality attributes. The production process inevitably will result in products exhibiting different quality characteristics and commanding different prices in the market, but producers generally will incur the same average cost for producing those agricultural products. In this situation, sales of the lower grade merchandise will be found to be below-cost, and margins will be found.

- The existence of futures contracts also can distort a dumping price analysis. The WTO *AD Agreement* defines sales during the period of investigation as sales with a date of sale in the period, and it generally uses contract or invoice date as the date of sale (whenever the material terms of sale are set). Currency conversions also are made using the exchange rate on this date of sale. But in futures sales, the date of delivery affects the price, which current antidumping law does not take into account.

  - The distortions are greatest in the U.S. during annual reviews, rather than in an investigation. As noted above, in investigations, POI average prices are compared, but in reviews, monthly prices are compared. For products with seasonal price fluctuations, it is highly distorting to compare, say, a May spot sale with sales contracted in May for December delivery.

- With respect to costs of production, cash basis accounting can lead to distortions in the calculation of cost of production, creating a mismatch between the cash costs incurred in a period and the production in that period. Similarly, it has been Commerce's practice to impute a labor expense for family labor, even where there is no actual expenditure of funds.

- Issues also have arisen with respect to Commerce's allocation of financial expenses. Typically, a farm may borrow heavily to invest in land, with the loan secured by a mortgage on the property. Commerce's normal allocation methodology, however, is to allocate financial expenses to individual products in proportion to the cost of goods sold. Since land is a non-depreciable asset and is not included in the cost of goods sold, this can result in misallocation of financial expenses away from land-intensive activity (like grain farming) to less land intensive activity (like cattle).

- Turning to the injury analysis in a dumping case, it frequently is difficult for foreign respondents to win agricultural cases, because the products tend to be treated as commodities that compete primarily on the basis of price. If the U.S. market share of

the imported product is significant and increasing at the same time domestic U.S. prices are decreasing, an affirmative injury determination can be difficult to avoid.

Nature of U.S.-Canadian Agricultural Trade

- In proposing potential changes to the WTO AD Agreement (or the WTO *Agreement on Agriculture*), we are also mindful of the nature of U.S.-Canadian agricultural trade. With certain exceptions, the U.S. and Canadian markets are integrated, and agricultural products move freely across the border. Given that the Canadian market is much smaller than the U.S. market, Canadian producers generally are price takers in the integrated market.

- There is thus no reason to suspect that sustained price discrimination could exist, with Canadian producers obtaining consistently higher prices in Canada than in the U.S.. Rather, findings of dumping are more likely to result from the existence of below-cost sales in Canada during cyclical downturns. This circumstance highlights the unfairness of burdening Canadian producers with dumping duties in situations where economic forces beyond their control, not predatory pricing, are responsible for both the price levels in the U.S. and the general state of the North American industry.

Special Agricultural Provisions in U.S. Dumping Law

- The current WTO AD Agreement contains no special provisions regarding agricultural products or industries. The U.S. antidumping statute and regulations, on the other hand, contain several such provisions:

    - First, the U.S. statute contains several provisions designed to enable producers of a raw agricultural product to file an antidumping petition against imports of a processed agricultural product produced from that raw agricultural product.[3] For example, producers of grapes can claim injury, and file a dumping petition, against imports of wine, and U.S. hog farmers can file a case against imports of both live swine and fresh or frozen pork. To gain standing to bring such a case, the statute requires that the processed agricultural product be produced from the raw agricultural product in a continuous line of production, and that there be a substantial coincidence of economic interest between the producers of the raw agricultural product and the producers of the processed agricultural product.[4]

    - Second, the U.S. statute contains a special below-cost test for highly perishable agricultural products. Both the WTO AD Agreement and the U.S. statute allow the dumping margin calculation to disregard home-market/third-country sales made at less than the cost of production (i) within an extended period of time, and (ii) in substantial quantities.[5] Normally, Commerce uses the one-year period

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[3] A raw agricultural product is defined as any farm or fishery product. 19 U.S.C. 1677(4)(E)(v).

[4] 19 U.S.C. 1677(9)(G); 19 U.S.C. 1677(4)(E). There is also a special provision in the threat section of the statute, applicable in cases involving both a raw and processed agricultural product, permitting the ITC to find threat based on the likelihood of product shifting, if it finds current injury on one product but not the other. 19 U.S.C. 1677(7)(F)(i)(VII).

[5] 19 U.S.C 1677b(b)(1)(A); AD Agreement Article 2.2.1.

of investigation as the "extended period of time", and applies the below-cost test by comparing each home market or third-country sale to the period average cost of production for that specific product. If less than 20% of sales by volume of that product over the period of investigation are found to be below the cost of production, Commerce does nothing and includes all such below-cost sales in calculating the weighted average home-market price. If, on the other hand, 20% or more of a product's sales are below the cost of production (a "substantial quantity" under the statute), Commerce excludes all such sales both in calculating the average home-market/third-country price for that product and in calculating the weighted average home market profit used for purposes of computing constructed value.[6]

- For highly perishable agricultural products, however, Commerce applies a different test. It compares the period average cost of production for the product to the weighted average price for the entire period of investigation. If the average price is higher than cost, i.e., on average, sales are made above the cost of production over the entire POI, Commerce does not exclude any home market sales. If, however, the weighted average cost exceeds the weighted average price, then Commerce excludes all below-cost sales. The provision can be highly beneficial to respondents, since it is less likely than the "20% test" to result in the exclusion of low-priced home-market or third-country sales in the antidumping comparison.

    - The theory behind this practice is that, for a highly perishable product, a producer inevitably will have a greater number of below-cost sales than with a non-perishable product. At the end of the day, the producer must accept whatever price the market will bear, since he cannot store the product.

    - Commerce has generally applied this provision restrictively, determining, for example, that while fresh roses constituted a highly perishable product, fresh salmon does not. (Commerce reasoned that a salmon grower has a harvesting window of several months within which it can decide to harvest its product, and thus can control the timing of its sale.) Also, Commerce's determination is made on a "product by product" basis -- which can undercut the benefits of this provision, depending on how narrowly products are defined.

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[6] See U.S.C. 1677b(b), 1677b(e)(2)(A) (providing for the calculation of CV profit based on sales made in the "ordinary course of trade", which is defined so as to exclude below-cost sales that are disregarded in the calculation of home-market/third-country price, 19 U.S.C. 1677(15)).

III. POTENTIAL PROPOSALS FOR MODIFYING THE WTO ANTIDUMPING AGREEMENT FOR AGRICULTURAL PRODUCTS

We have grouped our suggested proposals for modifying the WTO AD Agreement into three categories.

- First, we present an ambitious proposal for major changes in the way dumping is analyzed for cyclical agricultural industries.

- Second, we present proposals related to the standards a petitioner must meet to file a valid antidumping case. Improved standards for filing an antidumping petition, or for setting the threshold for initiation, are particularly beneficial, because they eliminate the uncertainty and expense associated with undergoing an antidumping investigation.

- Third, we present ideas for modifications to the margin calculation methodology, to set clearer requirements for producers to establish dumping. We pay particular attention to the "below-cost" test.

The three categories discussed necessarily overlap. Thus, for example, changes in the substantive rules governing the calculation of dumping margins that tailor dumping calculations to the agricultural context, or that adjust the basis on which the U.S. International Trade Commission (ITC), for example, can find material injury, necessarily also change the threshold burden on petitioners filing a petition.

A. Modifying the Standards for Cyclical Industry Dumping and Injury Findings

- One commonly heard complaint with respect to cyclical industries, particularly agriculture, is that a dumping case can always be brought during the downturn in the business cycle, when the domestic industry is performing poorly. This complaint was voiced in the Canada-U.S. cattle case, for example. Canadian producers felt it was unfair that a case could be brought during the downturn in the cattle cycle, where producers on both sides of the border may sell below their fully allocated costs of production and lose money or otherwise experience material injury.

    - A possible means of dealing with this situation is to require a petitioner, in a case involving a cyclical industry, to demonstrate in its petition that, during the POI, producers in the petitioning country were selling at or above the cost of production, before a case could be initiated (or at least before a below-cost investigation could be initiated against a respondent). The idea is that one should not allow dumping cases to be brought when both the domestic and foreign industries are selling below cost due to cyclical factors that are effectively beyond any individual producer's control.

    - Alternatively, for cyclical agricultural industries, one could require that the petition demonstrate dumping over a period of time extending beyond any cyclical downturn.

- This is an ambitious proposal because it radically restructures current antidumping requirements. It puts at issue the petitioning industry's own pricing practices, which

are not currently examined in deciding whether to accept a dumping petition, and/or it changes other threshold burdens for filing a case. If successful, however, this proposal would stop many antidumping cases from ever being filed.

- Implementing a change of this breadth would be challenging in many respects. It also would be necessary to develop a number of technical aspects of the proposal, including defining key concepts. Notwithstanding these issues, we believe it is useful to present this type of comprehensive approach to dealing with cyclical agricultural industries, since it clearly highlights the inequities in the current laws. Moreover, even if this comprehensive change in treatment can only be viewed as a long term goal, in the meantime, it may be possible to identify and address some of the specific issues of greatest concern to agricultural producers shipping into export markets. For example, several of our alternative proposals below address the below-cost issue that we believe is at the heart of the problem for cyclical agricultural industries.

- We have also considered the cyclicality problem in the context of injury determinations. Because cyclical industries normally would be in an injured state during the down phase of the business cycle, any reasonable injury test should evaluate injury over an entire cycle, or at least take into consideration the stage of the industry's business cycle. Although the WTO AD Agreement contains no special provisions in this regard, the U.S. antidumping statute as presently written, does, in fact, require the U.S. ITC to evaluate injury "within the context of the business cycle and conditions of competition that are distinctive to the affected industry."[7] The ITC thus does consider, in the case of a cyclical agricultural product, that the industry is at the downturn phase of the cycle in evaluating whether it is materially injured by reason of imports. This provision could, however, be strengthened and/or clarified by incorporating the same concept into the WTO AD Agreement, and specifically requiring consideration of whether the condition of the domestic industry can be expected to improve materially as a result of cyclical factors.

- Requiring the assessment of injury across the entire business cycle for cyclical agricultural industries would be another comprehensive approach to the cyclically problem. However, implementing this type of proposal would require radical revision to current injury analysis -- a significant challenge. Agricultural cycles, such as the hog cycle or cattle cycle can be of long duration, e.g., five to ten years. While it may be feasible for the U.S. International Trade Commission to use publicly available data to assess imports and the performance of the U.S. industry over such a long period of time, currently the ITC's injury determination focuses on a specific point in time, i.e., the present. It must evaluate whether present imports, at the margins of dumping presently found by Commerce, are now a cause of material injury. Consideration of injury over a longer period would require a significantly different analysis. Moreover, the margin of dumping would necessarily have to play a diminished role in the ITC's decision making, since it would not be feasible for Commerce to analyze dumping over five-or ten-year periods. This, too, would require major changes to current dumping rules.

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[7] 19 U.S.C. § 1677(7)(C)(iii)

- Given the kinds of issues raised by extending an injury analysis over a longer period, major structural change to the injury analysis in dumping cases may need to be pursued as a long term goal. In the interim, however, a number of other proposals could be pursued to allow a fuller and fairer assessment of the impact of cyclical factors on the condition of domestic agricultural industries. These more modest proposals, along with some proposals to change the threshold for bringing a dumping claim with respect to certain agricultural products are outlined below.

B. Potential Amendments Pertaining To Initiation

1. Require a Demonstration of Industry Support from Actual Producers, Not Surrogates

- In the Canada-U.S. cattle case, both the petitioner, and Commerce in its initiation decision, gauged the level of U.S. domestic industry support by contacting various trade associations rather than producers themselves. Article 5.4 of the AD Agreement could be clarified to require that support must be measured from actual producers, and to preclude industry support from being measured with reference to other entities, like trade associations, farm bureaus, etc.

    - First, trade associations have no inherent authority to speak on behalf of their members with respect to legal action, including antidumping cases. Second, reliance upon associations rather than individual producers miscounts the level of support, since associations are counted either as fully supporting or fully opposing a petition, whereas an association's membership and/or leadership may be divided on the issue. Third, reliance upon associations can result in double counting, since individual producers can belong to multiple associations.

    - This type of change to the AD Agreement's provisions on industry support can properly be characterized more as a clarification of the existing agreement than a modification to it. Article 5.4 of the AD Agreement, as written, requires an examination of whether sufficient support exists from "domestic producers." Trade associations are not domestic producers. Moreover, the paragraph explicitly deals with the issue of fragmented industries, stating that "in the case of fragmented industries involving an exceptionally large number of producers, authorities may determine support and opposition by using statistically valid sampling techniques." By expressly providing for the sampling of individual producers, the existing AD Agreement implicitly does not permit an importing country to establish industry support through the use of surrogates such as trade associations.

- Further, the AD Agreement should expressly require that the petition itself must establish a minimum level of industry support by affirmatively establishing the support of sufficient individual producers, rather than trade associations. At present, under the U.S. statute, a petitioner need only allege, rather than establish, the requisite level of industry support, and then Commerce must poll the industry. Shifting more of this burden to a petitioner increases the credibility of the petition and provides greater assurance that the affected industry actually is behind the petition before a case can be filed.

2. Raise the De Minimis Margin Level for Agricultural Products

- Article 5.8 of the AD Agreement provides that the margin of dumping shall be considered to be de minimis if the margin is less than 2%, expressed as a percentage of the export price. The higher the de minimis level, the more difficult it is to allege dumping in a petition or to prove dumping in any investigation.

    - A higher de minimis level for agricultural products - say 5.0% - could be justified on several grounds. First, the cyclical nature of many agricultural industries almost inevitably leads to more below-cost sales than for manufactured products, and this translates into higher dumping margins. However, these types of below cost sales are normal and necessary, not an unfair trade practice. Raising the de minimis threshold recognizes that agriculture is different.

    - Second, the long production cycle for many farm products lessens a producer's ability to adjust production in the short-term to respond to price changes. Again, a higher de minimis threshold recognizes that the below-cost sales that result should not be deemed an unfair trade practice.

    - Third, the dumping calculations for agricultural products are necessarily more imprecise than for manufactured products, given the frequent inability of producers to calculate different costs of production for different grades of a product, the general lack of sophisticated GAAP-based cost accounting systems, and the need to allocate costs imprecisely across multiple agricultural products. Raising the de minimis threshold recognizes the need to include a greater margin of error in the dumping calculations for agricultural products.

3. Eliminate the Below-Cost Test Entirely for Agricultural Products

- As the analysis above demonstrates, below-cost sales are frequently "normal and necessary" for agricultural products, for a variety of reasons. One solution to the potential for erroneously penalizing these sales through a dumping action is not to define below-cost agricultural sales as an unfair trade practice. This can be accomplished by simply eliminating the below-cost test for certain for all agricultural products.

- If this change were implemented, a petitioner would be required to demonstrate price discrimination to make a dumping claim. That is, in a U.S. case against a Canadian product, for example, prices in Canada would have to be higher than prices in the U.S. to trigger potential additional duties. Given the integration of the two markets and the fact that producers generally do not engage in the more complex export transactions unless they can earn a higher return than on domestic sales, this approach would eliminate many potential agricultural dumping claims.

- As suggested above, elimination of the test could be justified based both on reasons why below-cost sales are necessary in agriculture, and because meaningful cost of production data can, in any event, be difficult to obtain.

- As noted above, the U.S. antidumping statute already draws a distinction between raw and processed agricultural products. Because below-cost problems generally

affect raw agricultural products more than processed products, one possible approach would be to suggest such a provision only for raw agricultural products (i.e., products produced at a farm or fishery).

4. Raise the Threshold for Negligible Market Share

- Paragraph 5.8 of the AD Agreement provides that the volume of dumped imports shall normally be regarded as negligible if the volume of dumped imports from a particular country accounts for less than 3% of the imports in the importing country, unless individual countries each accounting for less than 3% of imports collectively account for more than 7% of imports. If the market share of imports from a country is negligible, no dumping case can be filed against that country. Obviously, the higher the "negligibility" threshold, the lower the risk of a dumping case being filed. Although more study would be necessary, it is possible that a higher "negligibility" threshold would be appropriate for agriculture cases.

5. Lengthening the Period of Investigation for Determining Dumping

- Presently, the U.S. uses a one-year period of investigation in measuring dumping. The below-cost test is applied over that one-year period, and the weighted average margin is calculated based on average U.S. prices and average home-market/third-country prices on a product-specific basis, over that one-year period. The one-year period for measuring the volume of below cost sales generally is implied by paragraph 2.2.1 of the AD Agreement. This provision prescribes the exclusion of below-cost sales made "within an extended period of time," and this term is expressly defined to be one year, normally, but in no case less than six months.

- If the "extended period of time" were defined for raw agricultural products as a two-year period, for example, this, in effect, would require Commerce to perform its antidumping analysis using a two-year period, since it would have to compare two years of costs to two years of sales. Lengthening the period may reduce the likelihood of below-cost investigations and findings, particularly if this change were combined with a requirement that the special below-cost test now applied in the U.S. only for highly perishable products be applied to all raw agricultural products (see proposal below).

- Again, the theory would be that agricultural industries are inherently cyclical and have more extended periods of below-cost sales than manufactured products. This circumstance justifies a longer period of investigation for measuring whether truly "unfair" below-cost sales are occurring.[8]

6. Apply a Market Concentration Test as a Threshold Requirement for Initiating a Dumping Investigation

- In the antitrust context, U.S. authorities evaluate mergers using an index designed to measure the degree of market concentration in the industry. The index is calculated

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[8] Of course, lengthening the period of investigation increases the reporting requirements and burdens on respondents, which is also a factor to be considered.

based on the market shares of the largest producers. The concept is that price competition is thwarted in an industry that becomes too concentrated.

- Since the antidumping law is essentially a price discrimination statute, it can be argued that its application makes sense only in industries in which the participants have some degree of pricing power. In highly fragmented industries, each market participant is a price taker and has no pricing power. Thus, the WTO AD Agreement could be modified to permit cases to be filed only where the industries in the importing and/or exporting countries have achieved certain levels of market concentration and where pricing power exists.

C. Proposals Affecting Antidumping Calculations

1. Modifications to the Below-Cost Test

- As noted above, the practical effect of applying the below-cost test is to broaden the concept of dumping beyond international price discrimination. Specifically, eliminating below-cost sales in the comparison market from the calculation of normal value increases the weighted average price of the remaining sales and thereby increases normal value. Thus, all other things remaining equal, the exclusion of below-cost sales has the effect of increasing dumping margins. The rationale for this exclusionary policy seems to be either that it will ensure companies are not engaged in predatory pricing below cost in an effort to drive competitors out of business, or that dumping simply should include below cost sales.

- Significantly, under the AD Agreement, not all below cost sales are excludable. Through the "substantial quantities" and "extended period of time" tests outlined above, the AD Agreement implicitly recognizes that some below-cost sales should not be removed from price calculations, because they are normal and necessary. For example, end of model year products and older inventory frequently must be sold at below cost prices to make way for new goods. Thus, when below-cost prices do not occur in substantial quantities or over an extended period of time, the AD Agreement does not permit their exclusion in the dumping calculations. The AD Agreement recognizes that antidumping comparisons would be distorted, and dumping margins artificially created, if normal below cost sales were excluded in computing the normal value.

- These provisions concerning the retention of below-cost rates in normal value calculations could be improved, however. For example, the AD Agreement's definitions of "extended period of time" and "substantial quantities" do not attempt to take into account the particular characteristics of the product and industry being investigated, because they do not examine the level of below-cost sales that would be normal or necessary in the particular situation under scrutiny. Instead, the current text contains inherently arbitrary tests, defining "substantial quantities" with a rigid 20% test, and providing that the "extended period time" should not exceed one year.

- This inflexibility in defining excludable below-cost sales is mitigated somewhat by the fact that the AD Agreement plainly gives the investigating authority the discretion to retain or to exclude below-cost sales, even if they are made in substantial quantities

over an extended period of time. The AD Agreement provides that the administering authority "may" treat below-cost sales as not being in the ordinary course of trade, and "may" disregard below-cost sales in computing normal value. This means that the authority also may leave these rates in its computation.

- However, given that administering authorities have a natural tendency to favor their domestic producers in any area where they have discretion to do so, it is important to add discipline to this analysis, so that it is even-handed. Currently, the AD Agreement does not define the circumstances under which it would be appropriate or inappropriate to exclude below-cost sales or mandate any analysis by the administering authority of the proper way to handle particular sales or industry pricing cycles. The present text permits the exclusion of below-cost sales whenever the minimum requirements of Article 2.2.1 are met, and this creates ample opportunities for protectionist influences in an importing country to require virtually automatic exclusion of below-cost sales.

a) Current U.S. Implementation of the Below-Cost Test

- In practice, the U.S. has implemented the below-cost test without exercising the discretion Article 2.2.1 permits to leave below-cost sales in the normal value calculation.
  - First, the U.S. almost always treats below-cost sales meeting the substantial quantities test as being outside the ordinary course of trade, and excludes them from the computation of normal value.[9]
  - Second, the U.S. has implemented the two tests for "substantial quantities" so as to restrict the applicability of the less restrictive, weighted average test in favor of the more restrictive 20% volume test. The U.S. applies the 20% volume test to all products except highly perishable agricultural products, to which it applies the weighted average per unit price to cost test.[10]
  - Third, the U.S. applies both the below-cost test and the substantial quantities test on a model-specific basis. Thus, in an investigation involving a hundred different models or product types, if 20% of the volume of model type is found to be below the cost of production for that model type, the U.S. will disregard those sales regardless of whether or not 20% of the volume of the like product as a whole is sold below the cost of production.
  - Fourth, the U.S. calculates and allocates costs in ways that increase the likelihood of below-cost sales.

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[9] The "extended period of time" test has no independent application in U.S. practice, as the U.S. normally will use a one-year period of investigation. The U.S applies the 20% test to this one-year period as a whole.

[10] The United States further defines highly perishable agricultural products restrictively. For example, the United States has determined that fresh roses constitute a highly perishable product, but that fresh salmon does not.

- Fifth, after excluding below-cost comparison market sales, the U.S. will base normal value on the remaining comparison market sales, no matter how few of these sales exist or how unrepresentative the remaining prices may be. For example, if all but one sale of a model in the comparison market is determined to be below the cost of production, the U.S. will continue to base normal value on the one remaining sale.

- Finally, where the U.S. below-cost test eliminates all domestic sales of a model or models, so the U.S. must calculate a "constructed value" for normal value, the U.S. requires this constructed value to incorporate a profit, even if no one in the industry is making any profit at the time.

• However, the unique attributes of agricultural products and industries can distort the antidumping analysis if traditional below-cost methodologies are applied inflexibly, as permitted under the current terms of the AD Agreement and as under current U.S. practice. For example,

- The number of below cost sales that are normal and necessary will tend to be higher for agricultural products than for manufactured products, yet the current AD Agreement applies the same "substantial quantities" test to all products. The high perishability of certain agricultural products, and/or the inability to control production in the short-term, may mean that producers have no choice but to continue producing and selling their products, even under poor market conditions and declining prices, because they cannot decrease production in response to short-term price declines. Below cost sales are not simply a matter of model closeouts, and thus the 20% test is ill suited for agricultural products.

- The lengthy production cycle means that below cost sales may be normal and necessary for longer periods of time than for manufactured products. Additionally, the existence of boom and bust seasonal pricing cycles can make it necessary for producers to sell at below-cost prices for extended period of times during the down phase of the cycle, whereas average prices may be above cost over the entire cycle. This cycle, moreover, is likely to last well beyond the one-year period contemplated in the current AD Agreement. Thus, the current definition of "extended period of time" is too restrictive.

- The degree and extent of below-cost sales can be exaggerated where models are differentiated based on physical characteristics for which cost of production differences cannot be calculated. Invariably, many more sales of the lower grade, smaller size, lower value size merchandise will be found to be below-cost, increasing the margin of dumping found for those models. But this is a false, mismatched comparison, as an average cost of production across all models cannot meaningfully be compared to prices for individual models. Plainly, not all models, and not all grades and sizes of a product, can be above average.

- Accurate costs of production that match sales during the investigated period also may be difficult to compute for small agricultural producers. Many family farms use cash basis rather than accrual accounting, which can lead to distortions in the calculation of a cost of production. This can lead to a serious mismatch between the costs calculated for the investigated period and the actual costs

attributable to production in that period. Similarly, family members may provide uncompensated labor. Should such labor be counted as a production cost, when no actual cost is incurred? If so, how should a value be attributed, particularly when farmers in the export market are behaving exactly the same way? The current AD Agreement fails to address these issues, but the U.S. requires "market" labor costs to be imputed and does not adjust for cost distortions created by lack of sophisticated accounting systems.

b) Proposals for Adapting the Below-Cost test to the Realities of Agricultural Products and Markets

- If investigating authorities implemented the below cost test with the flexibility already built into the AD Agreement, there would be fewer problems. As noted, the AD Agreement does not compel investigating authorities to exclude below-cost sales. Nor does the AD Agreement compel investigating authorities to limit the extended period of time over which cost and prices are analyzed to one year. Finally, the AD Agreement does not compel investigating authorities to use the 20% volume test in all cases. Nevertheless, it imposes no restrictions on doing so, and, as noted, this has been the practice of such countries as the U.S. The result has been unfair antidumping margin calculations for certain agricultural products.

- The fundamental problem in the current below-cost test is that it contains no requirement that the below-cost methodology be applied in a fashion that takes into account the particular characteristics of the industry to which the test is being applied. The premise of the "substantial quantities" test is that a certain level of below-cost sales is normal and necessary in all industries. Yet, the 20% test is inherently arbitrary. As noted, it may be appropriate for manufactured products, where the typical normal and necessary below-cost sales consist entirely of model closeouts. However, a 20% test is entirely *inappropriate* for agricultural products subject to cyclicality, seasonality in supply or demand, and/or long production cycles.

- Similarly, the premise of the "extended period of time" parameter is that products may be subject to seasonal supply and demand fluctuation but that over a "reasonable" period of time, sales on average should be made above the cost of production. It must be recognized, however, this reasonable period of time may differ from industry to industry, and particularly as between manufactured products and agricultural products.

- Other problems with costs include the issues of how to allocate joint production costs fairly across high and low value end product; the problems of imputing "market" labor costs to farmers' time when the farmers in the export market do not do this; and the practical problems of dealing fairly with limited accounting records or cash basis accounting not based on generally accepted accounting principles.

- As we noted in our discussion on initiation requirements for AD actions, many agricultural products, particularly those that are farmed, are produced in the exporting country by thousands of producers where none has market power or

the ability to control prices. For such products, it makes little sense to apply a below-cost test at all. The producer has no choice but to take the market price, even if it is below-cost. The producer cannot elect not to produce, as the crop already has been planted, or the livestock grown. In such situations, the purposes of the AD Agreement can be achieved simply by retaining the pure, price discrimination aspect of dumping, and eliminating the below-cost component. As long as the producer is not selling to the importing company at a price lower than it is selling in its home market or third country market, it should not be found to be dumping. If the below-cost test is retained, meaningful reform must require a more flexible application, in recognition of the typical characteristics of agricultural products and markets. A "one size fits all" analysis for all industries and all products is inherently arbitrary. Several such proposals follow.

(i) Modify the Substantial Quantities Test for Agricultural Products

- The 20% volume test for "substantial quantities" plainly is an arbitrary test, intended for manufactured products, that has no inherent validity for agricultural products. It should not be applied to agricultural products. Instead, agricultural products could be made automatically subject to the alternative substantial quantities test, whereby below-cost sales are excluded in the calculation of normal value only if the weighted average cost exceeds the weighted average price over the entire extended period of time examined.

- Alternatively, a higher volume-based test could be negotiated, or the requirement could be imposed that the investigating authority determine, based upon the nature of the product and market investigated, the level of below cost sales normal and necessary for that industry. Only sales above that industry specific level would be subject to elimination.

(ii) Extend the "Extended Period of Time"

- In light of the lengthy production cycle for many agricultural products, the "extended period of time" over which the existence of below-cost sales is assessed may be inappropriately limited to one year. Consideration should be given to requiring an analysis over the length of the production cycle typical of the industry, or even the pricing cycle for industries typified by boom and bust cycles. We recognize, however, that extending the period to be investigated over multiple years entails potential practical difficulties in terms of creating burdensome data requirements from producers.

(iii) Impose a Requirement that any Prices Used After Application of the Below-Cost Test be Representative

- Given the commodity nature of most agricultural products, prices can fluctuate greatly over a period of investigation. Prices may trend upward over a period, or they may trend downward. The result of applying a below-cost test in these circumstances can be that only the highest price points in the cycle remain after below-cost sales are excluded. Yet these prices are not fairly representative of the producer's pricing in its comparison market *over the entire period of*

investigation, and thus can provide an unrepresentative and inappropriate basis for normal value.

- If other solutions discussed above are not adopted, correction of this problem for agricultural products may require limitations on the use of comparison market prices as the basis for normal value, when application of the below cost test leaves few remaining above cost sales. Particularly where average prices over a period of investigation are used in price-to-price comparisons, and price movements over that period were significant, there must be some requirement that the sales remaining after application of the below cost test be representative of prices over the entire period. Otherwise, a few atypical high price, high profit, comparison market sales could provide an unrepresentative, unrealistic basis for normal value.

- In circumstances where comparison market prices cannot be used as the basis for normal value, here again, adjustments are necessary to ensure a fair normal value. The U.S.'s practice has been to require that constructed value include not only fully allocated production costs but also a positive amount for profit, even where the producer has not earned a profit in its comparison market. In light of the lengthy production cycles for agricultural products, and the existence of boom and bust cycles, there may be extended periods of time when producers are unable to earn a profit in their comparison market. In such circumstances, it is unfair to calculate normal value on the basis of a constructed value that includes what is, by definition, an inherently arbitrary profit amount. The AD Agreement should make clear that in appropriate circumstances, the profit component of constructed value can be zero or even negative.

(iv) Require that Prices be Compared to Costs Only at the Level of Specificity for Which Costs can be Calculated

- Obviously, the below-cost test can function as intended only if costs are computed and prices compared on the same basis. As noted above, agricultural products may be produced and sold in different grades or sizes with different values, yet the producer may be able to compute only a single average cost of production if a volume based cost calculation is used. When this average cost of production is compared to the prices for the individual grades and models, invariably the lower grade products will disproportionately be sold below their cost of production. It is a mathematical fact that not all models can be sold at above average prices.

- This problem can be solved in one of two ways:

    - First, the prices can be averaged so that there is a match between the basis on which costs are calculated and the basis on which prices are averaged. If only a single average cost can be calculated for all models, this single average cost should be compared only to a single average price for all models combined.

    - Second, it can be recognized that the different models of agricultural products produced are joint products, and the agreement can require a value-based

allocation of costs rather than a volume based allocation of costs for such joint products. That is, instead of computing a single average cost based on the volume produced, the pool joint production costs for all the different models would be allocated to each in proportion to their relative values.

This well-recognized method of accounting for joint production costs recognizes that a rational producer will produce joint products as long as the combined revenue from all the joint products exceeds the total costs of production. For example, it may cost a meat packing plant $0.75 per kilogram to purchase and process a hog, yet not every kilogram of that hog has the same value. The pork tenderloin and pork chops will be sold at higher prices than the skin or the knuckle. Value-based cost allocations ensure that costs are allocated to each product in proportion to their revenue contribution. All products thus are treated as having the same profit, rather than the more valuable products showing consistently unrealistic high profits and the lower value products showing consistent losses. In the context of an antidumping analysis, the latter approach is highly distortive.

(v) Consider only Variable Production Costs in the Cost of Production Analysis

- Basic microeconomics teaches that a profit-maximizing producer will continue to produce and sell products as long as it can recover its marginal variable costs of production. Yet the current below-cost test compares prices to a fully-burdened cost of production that includes not only variable production costs, but also fixed manufacturing costs, and such fixed overhead costs as interest expenses and general and administrative overhead. Economically rational, profit maximizing, pricing practices thus are effectively treated as unfair international trade practices.

- Therefore, consideration should be given to excluding only sales below the variable cost of production.

2. Provide More Detailed Rules Governing the Calculation of Costs of Production

- Calculating accurate costs of production for agricultural products can be problematic because producers may not apply generally accepted accounting principles, may not use cost-accounting or otherwise separately track costs for the different individual products it may produce, and may not include compensation for owner labor. Any changes in dumping rules to take these circumstances into account and thus lower the calculated cost of production obviously also will tend to lower the margin of dumping.

- The simplest and most beneficial modification might be a clearer requirement that production costs should consist only of costs actually incurred, and cannot include imputed costs, such as for uncompensated owner labor[11]. Another suggestion

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[11] It can be argued that the current agreement permits the inclusion only of actual costs. The U.S. Department of Commerce nonetheless views the individual farmer as a separate and distinct person

would be to require that financial expenses must be reasonably allocated across different products produced, specifically recognizing that, for agricultural products, nondepreciable assets such as land are used in production and should be allocated financing costs.

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related to the farm, and considers the provision of labor by the farmer to the farm to be a related party transaction which it can value at market value.